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SUBJECT: Ghana - Signs of Economic Overheating

REF: Accra 811

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¶1. (SBU) Summary: In the wake of its most recent mission to Ghana, the IMF expressed concern about an overall worsening of the macro-economic situation and signs that the economy may be overheating. While growth continues to be strong, foreign reserves are at worrisome levels, inflation seems stuck at about 10% and the public sector wage bill continues to grow. The IMF believes fast action is needed to control government expenditures and private sector demand to avoid a ballooning fiscal deficit and higher inflation in the months to come. The Bank of Ghana took a first step to cool demand by raising the prime rate from 12.5% to 13.5% on November 6. End Summary.

¶2. (SBU) On November 2, IMF ResRep and D.C.-based country Director briefed development partners November 2 at the conclusion of their October 29-November 2. The purpose of the Mission had been to discuss the medium term macro-economic framework with a view to developing a Policy Support Instrument (PSI), a non-lending monitoring program. However, in light of the more immediate problems that surfaced, the IMF Mission was not able to address substantially the medium term framework.

¶3. (SBU) In contrast to the upbeat assessment presented after its Mission in late March (reftel), the Fund expressed considerable concern about a potentially overheating economy, worsening macro-economic picture and stalled reform, especially in the public sector.

On the positive side:
- Growth remains strong. 2007 growth is estimated to be about 6.4% and the IMF concurs with GoG's growth projection of 7% for 2008.
- Revenue projections are being met after several years of shortfalls due in part to improved enforcement.
- Ghana's Terms of Trade (ToT) improved in spite of increased oil prices. Note: the Bank of Ghana, however, reported on November 6 that the previously improving ToT had reversed starting in March 2007 and, as of September 2007, ToT were worse than in September ¶2006. End note.
- Private sector demand and credit are up (a positive development but also contributing to possible overheating).

On the worrisome side:

- Inflation is stuck at about 10% vice the 7%-9% the Bank of Ghana is seeking (note: per the IMF the average in sub-Saharan Africa is 7.5% if you exclude Zimbabwe. End note).
- The current account has worsened in spite of improved Terms of Trade (there is a very high import content to spending).
- Reserves are at only 2.3 months import cover (three months is the

target)
- The fiscal deficit is expected to be about 8.2% of GDP in 07.
- Debt ratios are coming back up - total debt (domestic, external and other, e.g. Tema Oil Refinery bonds) are at about 46% of GDP; 60% of the debt is non-concessional.

¶4. (SBU) The key drivers of the indicators of concern include:
- Government expenditures well above target are caused in large part by the public sector wage bill, which is expected to be in the neighborhood of 10% of GDP (versus 9.6% last year)

- Energy subsidies. The recent tariff increases are a positive step but tariffs are still not at cost recovery levels.

- Despite robust cocoa/gold exports and remittances, increased imports for energy including higher prices for crude have been significant factors contributing to the worsening reserves situation.

¶5. (SBU) The IMF also noted that GOG records indicate that donor resources had declined, both nominally and as a percentage of GDP, exacerbating the budget woes. However, as the discussion with development partners unfolded, it became clear that there is a need to take a closer look because the development partners have different (higher) numbers than the GoG is using. Beginning January 1, the UK Development Agency, DFID, will post an official at the IMF office in Accra to help gather harmonized data on donor resources.

¶6. The GoG is not simply standing by. Energy tariff increases have been put in place but more is needed. A public sector head count is nearing completion, which will give the GoG a handle on numbers and locations of public sector employees. This is a first step toward getting more centralized control over hiring and salaries. Most significantly, the Bank of Ghana announced an increase in the prime rate from 12.5% to 13.5% on November 6 to cool demand. The IMF ResRep said this was something the IMF would favor but it had not been discussed with the GoG.

¶6. (SBU) Comment: Many of the factors such as the public sector wage bill and fiscal expansion that are of increasing concern to the IMF have been present for some time. During the last IMF Mission, there was the sense that the GoG had a solid plan to address the challenges. Eight months later, many of the plans remain on the drawing board. With the upcoming election, it will be politically difficult to reign in spending and public sector employment. Nevertheless, we should not be overly alarmist. The Bank of Ghana's action on the prime rate and a vibrant public debate over the need for further energy tariff increases are positive signs that the GoG is taking the worrisome signs seriously. End Comment.

BRIDGEWATER